

**REPORT OF THE AUDIT OF THE
KNOTT COUNTY
CLERK**

**For The Year Ended
December 31, 2003**



**CRIT LUALLEN
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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
Honorable Ernie Fletcher, Governor
Robbie Rudolph, Secretary
Finance and Administration Cabinet
Honorable Donnie Newsome, Knott County Judge/Executive
Honorable Ken Gayheart, Knott County Clerk
Members of the Knott County Fiscal Court

The enclosed report prepared by Morgan-Franklin, LLC, Certified Public Accountants, presents the statement of revenues, expenditures, and excess fees of the County Clerk of Knott County, Kentucky, for the year ended December 31, 2003.

We engaged Morgan-Franklin, LLC to perform the audit of this statement. We worked closely with the firm during our report review process; Morgan-Franklin, LLC evaluated the Knott County Clerk's internal controls and compliance with applicable laws and regulations.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen".

Crit Luallen
Auditor of Public Accounts

Enclosure



**REPORT OF THE AUDIT OF THE
KNOTT COUNTY
CLERK**

**For The Year Ended
December 31, 2003**

**Morgan-Franklin, LLC
P.O. Box 428
513 Main Street
West Liberty, KY 41472**

EXECUTIVE SUMMARY

AUDIT EXAMINATION OF THE KNOTT COUNTY CLERK

**For The Year Ended
December 31, 2003**

Morgan-Franklin, LLC has completed the Knott County Clerk's audit for the year ended December 31, 2003. Based upon the audit work performed, the financial statement presents fairly in all material respects, the revenues, expenditures, and excess fees in conformity with the regulatory basis of accounting described in Note 1.

Financial Condition:

Excess fees decreased by \$1,660 from the prior year, resulting in excess fees of \$13,489 as of December 31, 2003. Revenues increased by \$258,089 from the prior year and expenditures increased by \$259,749.

Report Comments:

- The County Clerk Did Not Require The Depository Institution To Pledge Or Provide Sufficient Collateral To Protect Deposits
- The County Clerk's Office Lacks Adequate Segregation Of Duties

Deposits:

The County Clerk's deposits were not properly insured and collateralized by bank securities or bonds.

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Morgan-Franklin, LLC

**P.O. Box 428
513 Main Street
West Liberty, KY 41472**

The Honorable Donnie Newsome, Knott County Judge/Executive
The Honorable Ken Gayheart, Knott County Clerk
Members of the Knott County Fiscal Court

Independent Auditors' Report

We have audited the accompanying statement of revenues, expenditures, and excess fees - regulatory basis of the County Clerk of Knott County, Kentucky, for the year ended December 31, 2003. This financial statement is the responsibility of the County Clerk. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for County Fee Officials issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the County Clerk's office prepares the financial statement on a regulatory basis of accounting that demonstrates compliance with the laws of Kentucky, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the revenues, expenditures, and excess fees of the County Clerk for the year ended December 31, 2003, in conformity with the regulatory basis of accounting.

In accordance with Government Auditing Standards, we have also issued our report dated October 21, 2004, on our consideration of the County Clerk's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The Honorable Donnie Newsome, Knott County Judge/Executive
The Honorable Ken Gayheart, Knott County Clerk
Members of the Knott County Fiscal Court

Based on the results of our audit, we have presented the accompanying comments and recommendations, included herein, which discusses the following report comments:

- The County Clerk Did Not Require The Depository Institution To Pledge Or Provide Sufficient Collateral To Protect Deposits
- The County Clerk's Office Lacks Adequate Segregation Of Duties

This report is intended solely for the information and use of the County Clerk and Fiscal Court of Knott County, Kentucky, and the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

Morgan - Franklin, LLC

Morgan-Franklin, LLC

Audit fieldwork completed -
October 21, 2004

KNOTT COUNTY
 KEN GAYHEART, COUNTY CLERK
STATEMENT OF REVENUES, EXPENDITURES, AND EXCESS FEES - REGULATORY BASIS

For The Year Ended December 31, 2003

Revenues

State Fees For Services	\$	15,412
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Fiscal Court		4,059
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Licenses and Taxes:

Motor Vehicle-

Licenses and Transfers	\$	522,141
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Usage Tax		1,077,823
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Tangible Personal Property Tax		868,983
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Licenses-

Fish and Game		10,050
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Marriage		5,003
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Deed Transfer Tax		10,983
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Delinquent Tax	165,017	2,660,000
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Fees Collected for Services:

Recordings-

Deeds, Easements, and Contracts	\$	9,581
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Real Estate Mortgages		20,161
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Chattel Mortgages and Financing Statements		53,340
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All Other Recordings		26,931
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Charges for Other Services-

Miscellaneous	217	110,230
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Interest Earned		704
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Total Revenues	\$	2,790,405
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The accompanying notes are an integral part of this financial statement.

KNOTT COUNTY
 KEN GAYHEART, COUNTY CLERK
 STATEMENT OF REVENUES, EXPENDITURES, AND EXCESS FEES - REGULATORY BASIS
 For The Year Ended December 31, 2003
 (Continued)

Expenditures

Payments to State:

Motor Vehicle-

Licenses and Transfers	\$	432,310	
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Usage Tax		1,043,215	
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Tangible Personal Property Tax		378,185	
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Licenses, Taxes, and Fees-

Fish and Game		9,712	
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Delinquent Tax		23,455	
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Legal Process Tax		13,987	\$ 1,900,864
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Payments to Fiscal Court:

Tangible Personal Property Tax	\$	92,525	
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Delinquent Tax		18,409	
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Deed Transfer Tax		8,757	119,691
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Payments to Other Districts:

Tangible Personal Property Tax	\$	363,513	
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Delinquent Tax		77,781	441,294
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Payments to Sheriff			3,637
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Payments to County Attorney			24,269
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Operating Expenditures

Personnel Services-

Deputies' Salaries	\$	155,411	
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Employee Benefits-

Employer's Share Social Security		17,604	
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Employer's Share Retirement		12,942	
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Contracted Services-

Legal And Accounting		4,660	
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Contract Labor		1,586	
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Printing and Binding		2,774	
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The accompanying notes are an integral part of this financial statement.

KNOTT COUNTY
 KEN GAYHEART, COUNTY CLERK
 STATEMENT OF REVENUES, EXPENDITURES, AND EXCESS FEES - REGULATORY BASIS
 For The Year Ended December 31, 2003
 (Continued)

Expenditures (Continued)

Operating Expenditures: (Continued)

Other Charges-		
Conventions and Travel	\$ 4,107	
Bank Charges	87	
Refunds	11,133	
Postage	5,473	
Miscellaneous Disbursements	995	\$ 216,772
Total Expenditures		<u>\$ 2,706,527</u>
Net Revenues		\$ 83,878
Less: Statutory Maximum		<u>63,753</u>
Excess Fees		\$ 20,125
Less: Expense Allowance	\$ 3,600	
Training Incentive Benefit	<u>3,036</u>	<u>6,636</u>
Excess Fees Due County for 2003		\$ 13,489
Payments to Fiscal Court - May 19, 2004		<u>13,404</u>
Balance Due Fiscal Court at Completion of Audit		<u><u>\$ 85</u></u>

The accompanying notes are an integral part of this financial statement.

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENT

December 31, 2003

Note 1. Summary of Significant Accounting Policies

A. Fund Accounting

A fee official uses a fund to report on the results of operations. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fee official uses a fund for fees to account for activities for which the government desires periodic determination of the excess of revenues over expenditures to facilitate management control, accountability, and compliance with laws.

B. Basis of Accounting

Kentucky Revised Statute (KRS) 64.820 directs the fiscal court to collect any amount, including excess fees, due from the County Clerk as determined by the audit. KRS 64.152 requires the County Clerk to settle excess fees with the fiscal court by March 15 each year.

The financial statement has been prepared on a regulatory basis of accounting, which demonstrates compliance with the laws of Kentucky and is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this regulatory basis of accounting, revenues and expenditures are generally recognized when cash is received or disbursed with the exception of accrual of the following items (not all-inclusive), at December 31, 2003, that may be included in the excess fees calculation:

- Interest receivable
- Collection on accounts due from others for 2003 services
- Reimbursements for 2003 activities
- Payments due other governmental entities for December tax and fee collections and payroll
- Payments due vendors for goods or services provided in 2003

The measurement focus of a fee official is upon excess fees. Remittance of excess fees is due to the County Treasurer in the subsequent year.

C. Cash and Investments

At the direction of the fiscal court, KRS 66.480 authorizes the County Clerk's office to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

KNOTT COUNTY
 NOTES TO FINANCIAL STATEMENT
 December 31, 2003
 (Continued)

Note 2. Employee Retirement System

The county officials and employees have elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a multiple-employer public retirement system that covers all eligible full-time employees.

Benefit contributions and provisions are established by statute. Nonhazardous covered employees are required to contribute 5.0 percent of their salary to the plan. The county's contribution rate for nonhazardous employees was 6.34 percent for the first six months and 7.34 percent for the last six months of the year.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65.

Historical trend information pertaining to CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report which is a matter of public record.

Note 3. Deposits

The County Clerk maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the County Clerk and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. The County Clerk entered into a written agreement with the depository institution and met requirements (a), (b), and (c) stated above. However, as of April 3, 2003, the collateral and FDIC insurance together did not equal or exceed the amount on deposit, leaving \$29,027 of public funds uninsured and unsecured. The county official's deposits are categorized below to give an indication of the level of risk assumed by the county official as of April 3, 2003.

	<u>Bank Balance</u>
FDIC insured	\$ 100,000
Collateralized with securities held by pledging depository institution in the county official's name	201,687
Uncollateralized and uninsured	<u>29,027</u>
Total	<u><u>\$ 330,714</u></u>

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COMMENTS AND RECOMMENDATIONS

KNOTT COUNTY
KEN GAYHEART, COUNTY CLERK
COMMENTS AND RECOMMENDATIONS

For The Year Ended December 31, 2003

STATE LAWS AND REGULATIONS:

The County Clerk Did Not Require The Depository Institution To Pledge Or Provide Sufficient Collateral To Protect Deposits

On April 3, 2003, \$29,027 of the County Clerk's deposits of public funds were uninsured and unsecured. According to KRS 66.480(1)(d) and KRS 41.240(4), financial institutions maintaining deposits of public funds are required to pledge securities or provide surety bonds as collateral to secure these deposits if the amounts on deposit exceed the \$100,000 amount of insurance coverage provided by the Federal Deposit Insurance Corporation (FDIC). We recommend the County Clerk require the depository institution to pledge or provide collateral in an amount sufficient to secure deposits of public funds at all times.

County Clerk Ken Gayheart's Response:

None

INTERNAL CONTROL - REPORTABLE CONDITIONS:

The County Clerk's Office Lacks Adequate Segregation Of Duties

During our audit we noted the County Clerk's internal control structure lacked an adequate segregation of duties. This deficiency occurs when someone has custody over assets and the responsibility of recording financial transactions. In our judgment, this condition could have adversely affected the former County Clerk's ability to record, process, summarize, and report accurate financial information. We recommend the County Clerk's Office obtain additional staff to divide the responsibilities or implement the following compensating controls that would help offset the lack of adequate segregation of duties:

- Cash recounted and deposited by the County Clerk
- Reconciliation of reports to source documents and receipts and disbursements ledgers by the County Clerk
- All disbursement checks are to be signed by two people and one must be the County Clerk
- The County Clerk examines payroll checks prepared by an employee and distributes checks to employees
- All disbursements checks prepared by an employee are examined by the County Clerk for proper documentation
- The County Clerk mails disbursements
- The County Clerk or someone independent of the County Clerk's Office prepares bank reconciliations

County Clerk Ken Gayheart's Response:

None

KNOTT COUNTY
KEN GAYHEART, COUNTY CLERK
COMMENTS AND RECOMMENDATIONS
For The Year Ended December 31, 2003
(Continued)

INTERNAL CONTROL - MATERIAL WEAKNESSES:

None.

PRIOR YEAR:

- Lacks Adequate Segregation Of Duties
- The County Clerk Should Require Depository Institutions To Pledge Or Provide Sufficient Collateral To Protect Deposits

REPORT ON COMPLIANCE
AND ON INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF THE FINANCIAL STATEMENT
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Morgan-Franklin, LLC

**P.O. Box 428
513 Main Street
West Liberty, KY 41472**

The Honorable Donnie Newsome, Knott County Judge/Executive
Honorable Ken Gayheart, Knott County Clerk
Members of the Knott County Fiscal Court

Report On Compliance And On Internal Control Over Financial Reporting Based On An Audit Of The Financial Statement Performed In Accordance With Government Auditing Standards

We have audited the statement of revenues, expenditures, and excess fees - regulatory basis of the Knott County Clerk for the year ended December 31, 2003, and have issued our report thereon dated October 21, 2004. This was a special report on the County Clerk's financial statement prepared in accordance with a basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Knott County Clerk's financial statement for the year ended December 31, 2003, is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under Government Auditing Standards and which is described in the accompanying comments and recommendations.

- The County Clerk Did Not Require The Depository Institution To Pledge Or Provide Sufficient Collateral To Protect Deposits

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Knott County Clerk's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statement. The reportable condition is described in the accompanying comments and recommendations.

Report On Compliance And On Internal Control
Over Financial Reporting Based On An Audit Of The Financial
Statement Performed In Accordance With Government Auditing Standards
(Continued)

Internal Control Over Financial Reporting (Continued)

- The County Clerk's Office Lacks Adequate Segregation Of Duties

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness.

This report is intended solely for the information and use of management and is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,

Morgan - Franklin, LLC

Morgan-Franklin, LLC

Audit fieldwork completed -
October 21, 2004

